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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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The Honorable Ernest F. Hollings
United States Senate

Dear Senator Hollings:

Your July 25, 1974, letter requested that we provide further information on the current status of the Department of Health, Education, and Welfare's (HEW's) actions concerning the grant made to the Health Maintenance Organization of South Carolina, Inc. (HMOSC). We provided you with an interim response on August 8, 1974. We have now completed our review of HMOSC's expenditures for March 15, 1974, through August 15, 1974. The expenditures for this period which totaled \$62,360.17 are summarized in the enclosure to this letter.

In his letter of March 15, 1974, advising HMOSC of his decision to suspend further payments under the grant until certain conditions were met, HEW's Acting Regional Health Administrator advised the Project Director that no new obligations could be incurred under the grant until certain information was submitted to and approved by the HEW regional office. In a subsequent letter dated May 15, 1974, advising HMOSC of his intention to terminate the grant, the Regional Health Administrator told the Project Director that:

"* * * any new expenditures of obligations made or incurred in connection with the grant during the period of this suspension will not be recognized by the Government. Expenditures to fulfill legally enforceable commitments made prior to the notice of suspension in our letter of March 15, 1974, in good faith and in accordance with your approved project, and not in anticipation of suspension or termination, will not be considered new expenditures."

The Assistant Regional Health Administrator interpreted these letters for us as authorizing HMOSC to pay recurring costs, such as salaries, rents, and utilities in accordance with the approved grant budget.

Our findings with regard to certain expenditures for the period covered by our current review are summarized below.

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PERSONAL SERVICES

Payments for personal services totaled \$48,229.25, or 77 percent of total expenditures during the period. Except as noted below, all amounts paid for personal services were either equal to or less than amounts specified in the approved grant budget and were otherwise in accordance with terms of the grant.

Payments to former Executive Director
not allowable charges to grant funds

The person named in the approved budget as occupying the position of Executive Director resigned from HMOSC effective April 15, 1974, but was paid at a salary rate of \$1,336.50 for April 16, 1974, through April 30, 1974. In addition, on April 25, 1974, he was paid \$1,336.50 for 2-weeks vacation.

HEW's policy statement for health services development grants under section 314(e) of the Public Health Service Act (42 U.S.C. 246e), which governs the use of grant funds by HMOSC, provides that salaries or wages are allowable charges against grant funds to the extent that they are for time and effort spent on a grant-supported project.

The policy statement also provides that fringe benefits are allowable charges against grant funds to the extent that such payments are made under formally established and consistently applied policies, uniformly charged as a direct cost on an actual rather than an estimated basis, and charged in proportion to salary charged to the grant. The policy statement further provides that leave is an allowable charge only when it is earned on the grant-supported project and prorated in accordance with the salary charged to the grant.

HMOSC had no written policy governing the payment of separation allowances or the granting of vacation time, and it kept no record of leave earned or used by its officers and employees.

Notwithstanding the absence of leave records, correspondence in HMOSC files and our own observations during our previous work at HMOSC indicate that the former Executive Director had taken substantial leave during the 5 months preceding his resignation. In a letter which he wrote to a HMOSC creditor on December 7, 1973, he stated that he had just returned from a 3-week vacation. Further, he was not at the HMOSC office for 2 weeks preceding his resignation and was in the HMOSC office only sporadically during the several weeks before that 2-week period.

We believe that the salary payment when no time or effort was spent on the project is not an allowable use of grant funds. It might be possible to look at the April 16 salary payment as a separation allowance, but in the absence of a formally established and consistently

applied policy relating to the payment of such allowances, we believe that such a payment would also be contrary to the terms of the grant and therefore not an allowable charge to grant funds.

In the absence of a formally established and consistently applied policy related to the granting of leave and the lack of reliable records on the use of leave, we believe that the April 25 payment to the former Executive Director for vacation cannot be considered an allowable use of grant funds.

Promotion of former Associate Director
violates conditions of grant suspension

In its letters dated March 15, 1974, and May 15, 1974, HEW specifically prohibited the use of grant funds to pay for obligations incurred after March 15, 1974, but stated that expenditures to fulfill legally enforceable obligations made before March 15, 1974, in good faith and in accordance with the approved project, and not in anticipation of suspension or termination, would be allowable.

The approved budget for the current grant year provided for payment of full salaries for all personnel through June 30, 1974, and for payment of half salaries beginning July 1, 1974. At that time, HMOSC was expected to become operational and the need for grant funds was expected to be reduced.

For the 6-month period beginning July 1, 1974, the grant provided Federal funds of \$8,019 for the salary of an Executive Director and \$4,725 for the salary of an Associate Director. These amounts are equivalent to semimonthly rates of \$668.25 and \$393.75, respectively; and to weekly rates of \$308.42 and \$181.73.

The person named in the grant budget as the Associate Director was paid the salary provided in the budget for that position through July 15, 1974. For two semimonthly pay periods beginning July 16, 1974, and for a 1-week period beginning August 16, 1974, he was paid at the salary rate provided in the budget for the Executive Director. He told us that he is now the Acting Executive Director. The difference between the salary paid to him for this period as Acting Executive Director and the amount that would have been paid to him as Associate Director is \$675.69.

We believe that under the stipulations contained in HEW's letters of March 15 and May 15, 1974, advising HMOSC first of the suspension and then of the intention to terminate the grant, the elevation of the former Associate Director to the position of Acting Executive Director must be viewed as a new obligation and that the \$675.69 cannot be considered an allowable charge against grant funds.

Salary payments exceeded budgeted amounts

The approved budget provided for a reduction in the amount of grant funds available for salaries of all personnel effective July 1, 1974.

The Federal funds provided in the budget for the salary of the Consumer Relations Director were equivalent to a semimonthly rate of \$382.50 through June 30, 1974, and \$191.25 thereafter.

The Consumer Relations Director was paid through July 15, 1974, the last date for which he was paid, at a rate of \$382.50--resulting in an overpayment of \$191.25.

The budgeted salary for the Project Director starting July 1, 1974, was equivalent to a semimonthly rate of \$712.83. At this rate the net amount payable to him semimonthly would be \$539.15. During July 1974, the Project Director received two checks for \$649.15 each--an overpayment of \$220.

The Acting Executive Director told us that these overpayments to the Project Director resulted from an error in subtraction and that \$220 would be deducted from the next salary payment made to the Project Director.

Payments for vacation
supplemented salaries

Three HMOSC employees received payments for vacations under circumstances which we think violate the HEW policy statement prohibition of bonuses or supplementation of base salaries.

The Consumer Relations Director, the Administrator, and the former Associate Director (now the Acting Executive Director) received regular semimonthly salary payments from January 1974 through July 15, July 31, and August 15, 1974, respectively. These were the last dates of employment for the Consumer Relations Director and the Administrator. The Acting Executive Director had received additional pay for 1 week beginning August 16, 1974. On June 14, 1974, in addition to their regular salary, these employees were paid for vacation time. The former Associate Director was paid at a salary rate of \$982.11 for 3-weeks vacation time. The Consumer Relations Director and the Administrator were paid at salary rates of \$353.08 and \$512.30, respectively, for 2-weeks vacation time.

As stated previously, HMOSC did not have a formally established and consistently applied policy related to the granting of leave and did not keep records of leave earned or used by employees. We found no indication of the leave history of the former Associate Director or the Consumer Relations Director, but in April 1974, during our

previous work at HMOSC, the Administrator took, and was paid for, a 2-week vacation.

We believe that these payments for vacations constitute supplementation of the base salaries of the employees and are therefore not allowable charges against grant funds.

TRAVEL

Travel expenses for the period covered by our current review totaled \$2,823.69. HMOSC still was not maintaining adequate records of travel expenses and travelers still were not accounting for travel advances.

Travel expenses exceed amount budgeted for travel

The approved budget for the grant year January 1, 1974, through December 31, 1974, included \$7,200 in Federal funds for travel. Information obtained during both our previous work at HMOSC and our current review shows that for the period January 1, 1974, through August 15, 1974, HMOSC's expenditures for travel totaled \$8,116.44--\$2,761.06 for travel within the Charleston area and \$5,355.38 for travel outside the area.

The HEW policy statement provides that grant funds may not be used to pay travel expenses in excess of the amount budgeted for travel without advance approval of HEW. HMOSC did not receive advance HEW approval to spend more than the budgeted amount. Thus, the amount spent in excess of the budgeted amount--\$916.44--is not an allowable charge against grant funds.

OTHER EXPENDITURES

Office rental

In June 1974 the amount of space occupied by HMOSC was reduced, with a resultant reduction in the monthly rental rate from \$1,300 to \$650.

Office equipment rental

Rented office equipment was relinquished on June 30, 1974, and there have been no rental payments since that date.

Telephone

The amount shown in the enclosure as expenditures for telephone service includes \$475 placed on deposit with a court to enjoin the telephone company from interfering with HMOSC's telephone service.

STATUS OF GRANT TERMINATION ACTION

By letter dated September 2, 1974, the HMOSC Director appealed to HEW's Departmental Grant Appeals Board the August 5, 1974, decision to terminate the grant--a right accorded to HMOSC under 45 CFR 16. When such an appeal is made, 45 CFR 16.7 provides that:

"* * * no action may be taken by the constituent agency pursuant to such determination until such application has been disposed of, except that the filing of the application shall not affect the authority which the constituent agency may have to suspend assistance under a grant during proceedings under this part or otherwise to withhold or defer payments under the grant."
(Underscoring supplied.)

HEW suspended further grant payments to HMOSC on March 15, 1974, and this suspension remains in effect. However, during the pendency of HEW's termination actions, HMOSC was permitted to continue operations using Federal funds made available to HMOSC before March 15, 1974.

The continuation of operations was subject to HEW instructions to HMOSC that:

"* * * any new expenditures of obligations made or incurred in connection with the grant during the period of this suspension will not be recognized by the Government. Expenditures to fulfill legally enforceable commitments made prior to the notice of suspension in our letter of March 15, 1974, in good faith and in accordance with your approved project, and not in anticipation of suspension or termination, will not be considered new expenditures."

Upon final determination that the grant be terminated, 42 CFR 51.414 requires a full accounting of the use of Federal funds by the grantee and provides that any amounts not properly accounted for shall constitute a debt owed by the grantee to the Federal Government and such debt shall be recovered from the grantee or its successors or assignees by setoff or other actions as provided by law.

As part of any grant termination action, HEW probably has powers, the extent of which are unsettled and highly speculative, under 45 CFR 74.112 which provides that:

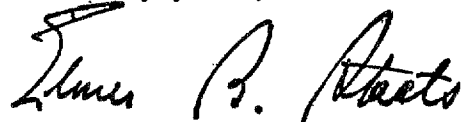
"* * * when a grantee has materially failed to comply with the terms and conditions of a grant, the granting agency may suspend the grant * * *, terminate the grant for cause * * *, or take such other remedies as may be legally available and appropriate in the circumstances."
(Underscoring supplied.)

In two lower court decisions on the same matter heard by the same judge, it was held that the United States may seek judicial enforcement of the terms and conditions of Federal grants without requiring the grantor agency to terminate these grants. United States v. Frazer, 297 F. Supp. 319 (M.D. Ala., N.D. 1968), 317 F. Supp. 1079 (M.D. Ala., N.D. 1970). Those cases, distinct from this situation, did not even contemplate bringing termination proceedings against the grantee. Moreover, they involved the failure of State grant administrators to enforce equal employment opportunity requirements of Federal law, a constitutional issue which is not present here. The importance of that distinction has been stressed elsewhere. Hadnott v. Laird, 463 F. 2d 304, 309 and n.14 (D.C. Cir. 1972).

Thus, HEW theoretically could sustain a suit against HMOSC to prevent the incurrence of new obligations or even to prevent the depletion of funds through old obligations improperly incurred and threatening to deplete the assets of the HMOSC so as to prevent ultimate recovery by the Government. Such a suit, however, would require high standards of proof and a showing that the Government would be irreparably damaged by the depletion as well as a balancing of the costs and time involved in such a judicial proceeding, versus the amount of money possibly recoverable. We have, at this time, seen few facts to meet this burden. On the basis of the facts we now have, we cannot disagree with HEW that the institution of such a suit is not practicable in this case, and that following the termination procedures is the proper course.

We have been advised that the HEW Audit Agency will review HMOSC's expenditure of grant funds from the closing date of our current review through the date of termination, if termination action is sustained by HEW's grant appeals board. We have agreed to make our working papers available to them. We trust that the above information is responsive to your request.

Sincerely yours,

A handwritten signature in dark ink, appearing to read "Thomas B. Ruck". The signature is fluid and cursive, with a large initial "T" and "B".

Comptroller General
of the United States

Enclosure

HMOSC's summary schedule of expenditures for
March 15, 1974, through August 15, 1974

	<u>Amount</u>	
Personal services:		
Salary payments (net)	\$27,329.06	
Social security taxes,		
income taxes withheld		
from salaries, and		
unemployment compensation		
tax	<u>20,900.19</u>	\$48,229.25
Travel:		
In area	363.72	
Out of area	<u>2,459.97</u>	2,823.69
Office supplies		655.20
Office rental		4,550.00
Office equipment rental		2,610.05
Consultants		1,125.60
Telephone		1,747.02
Other		<u>619.36</u>
Total		<u>\$62,360.17</u>